The Current Economic Crisis of the EU: Genesis, Analysis and Solutions

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Abstract: *The article approaches the current economic crisis from an historical perspective, analyzing the building of the monetary integration and the common currency. The process is explained through pointing out its effects on the European integration and outlining the positive and negative consequences of the introduction of a common currency in the European Union. The investigation continues with a general outlook of the current situation of the countries which were more affected by the current crisis—Greece, Ireland, Portugal, Spain, Italy and Cyprus. What all these countries have in common is the necessity of extra funding in a context of austerity, plus some national particularities. The author proposes an expansion in the public spending as the only reliable way to stimulate European economies in the crisis. As the introduction of the euro meant the end of the monetary independence for the Member States, an innovative solution is proposed—the creation of an Economic Government in the union in order to transfer funds from wealthier states to the countries in trouble. It is presented as a necessity for the states in crisis, a necessity for the wealthier states, and a must for the European Union.*

Keywords: *development of the European building process, economic crisis, European Union, integration, solutions, the euro*

1. Genesis

To understand the difficult times that the EU is going through, we have to revisit the origins of the organization and the pioneering ideas of the process of European integration. For centuries there have been thinkers who have proposed different forms of integration in Europe to avoid wars, which used to be considered the main problem in Europe. Most of them, including the German philosopher Kant and his work *Perpetual Peace: A Philosophical Sketch* ([1795] 2009), identified this problem with nationalism and the confrontation between nations on the European level, given Europe's international influence worldwide. The armed conflicts in Europe were the result of an exacerbated nationalist propaganda and of the need for internal cohesion in European countries in order to establish a strong foreign policy abroad. Building a national image was based on a country's differentiation from the outside.

Thus, since it very beginning, the process of European integration has been based on the abolition of political powers of the nation, relegating it to a cultural role. All these thinkers and politicians did not want to wipe out the concept of nation; they just wanted to undress their political form, while retaining cultural and emotional values. (Føllesdal & Koslowski, 2010, p. 87)

Immanuel Kant, Aristide Briand, Count Codenhove-Kalergi, Altiero Spinelli and Jean Monnet sought to develop a system of peace in Europe based on the integration of the various political entities on the European continent into a merger that would result in a higher political community managing the common good, encompassing all structures of power in a political institution at European level that would prevent conflicts between European states.

The biggest difference between all these ideas and proposals was, and still is, the various options to reach the desired content to European integration. In this regard there are various theories related to the process of European construction. These theories are important for studying what happened in the past, explaining what is happening today and what drives the process forward. However, there are three theories that prevail over the rest because of their popularity and influence during the whole process of European integration. These are *federalism*, *neo-functionalism* and *cooperation*.

Federalism is based on the construction of Europe and is grounded on two main premises, the legal and policy framework on the one hand, and citizens and democratic legitimacy on the other. Thus, federalism advocated the creation of a European executive, a strong common parliament and constitution, with the idea of creating the United States of Europe revolving around a principal axis, the European citizen, which would have the same rights and obligations irrespective of nationality.

Another important theory is *neo-functionalism*, which is based on the integration of areas of low political profile, mainly in economy, to prevent resistance from the social and political Europe. The fields of integration should be chosen according to their potential for deeper integration, which would cover more aspects. This would lead to a spiral effect where integration in a given field generates benefits for the society, but in turn creates new problems that can be solved only with more integration, reaching the European state as the final result of the integration process.

Finally, *cooperation* between the states has a great influence on the development of the European Union. It is based on agreements between the states and depends on the political, social and economic ability of each state to understand and reach agreements without resorting to extreme decisions, such as the use of violence or freezing relations. Today the ability to reach agreements determines the jumps of integration caused by other reasons, and has its highest expression in the European Council policy requiring unanimity for approval.

The European Union today is the result of an amalgamation of federalism, cooperation and neo-functionalism, and other minor influences. It gives a special character to the process of European construction, being unique in the world. (Rodríguez-Pose, 2002, p. 167)

The importance of understanding the nature of the current EU is only one stage in the process of construction, the ultimate goal of which is the attainment of a European state. As we are neither at the end of the process, nor in a static situation, more reforms will be included in the European building process in the long term, and thus more reforms affecting the common currency will surely take place. Thus, the problems that the EU faces today are short-term, and are included in another, even bigger process which ultimately will lead to the creation of a European state, whose form and powers are still to be defined.

The word 'crisis' in Latin means change, and in this sense the EU has been in constant crisis since the creation of the Coal and Steel Community back in the 1950s until today, constantly changing its shape, policies and powers. This state of crisis would last until the achievement of the common goal—the European state. It is important to note that the process never had a regression in the integration, perhaps stoppages in the process, but never steps back. The integration model could be explained broadly through different stages which are repeated in a cycle, which is part of the overall process of Europe's construction. The cycle passes through integration, deepening, stabilization and stagnation, and a new cycle would begin anew, following the same pattern.

The first stage is the creation of new policies on the European level which would include different aspects that are integrated in a common management. Following the integration there is a period of deepening along the paths opened by the enhancing integration of community policies in order to absorb the different prerogatives of the Member States, which is managed on the European or supranational level. This progress in integration is slowing down to a state in which the stabilization process takes over and the different problems raised during the previous stages are being tackled. After that there is high integration and stagnation as a result of the process itself, as the fields or integrated policies begin to reveal problems that can only be resolved by integrating them further, including other new aspects, but are in some way related with the original policies. There is only one way out of the deadlock—further integration. The intention to keep the European Union stagnant, without further forward movement, without further integration, would mean the collapse of the organization because it would not be able to meet the new challenges generated through the previous integration. Obviously, this would lead to the demise of the organization, which would have devastating consequences for Europe, so that the Member States would not take that path lightly and finally would have to accept greater integration albeit as a lesser evil.

According to this model of integration in Europe, the organization always takes the Member States' policies and manages them according to a common pattern, but never returns the same policies to the states. The EU always takes, never returns. The EU absorbs all policies that have been under the power of the Member States to manage them jointly, but it never nationalizes, or reverses the community policies that are already in the European sphere to the Member States.

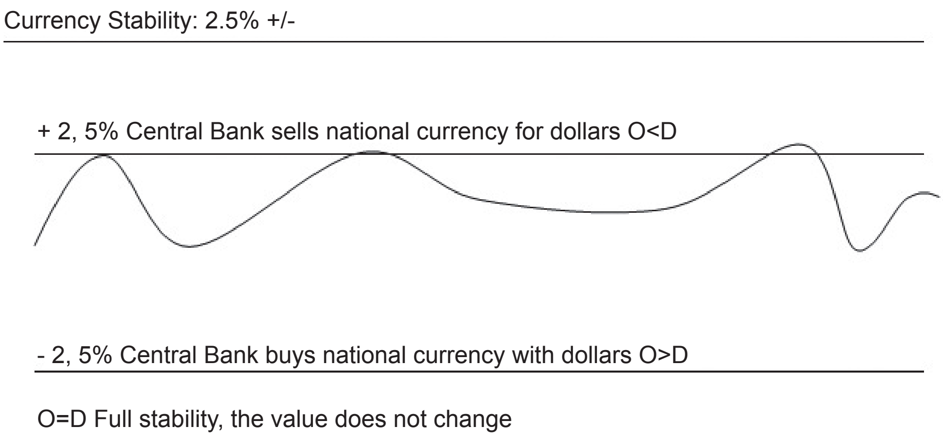
Currently, the process of Europe's construction is in a delicate stage of stagnation that will be followed by another phase of integration. The EU's current problems will be solved with more integration, but, of course, not before overcoming the reluctance of national governments of the various current EU Member States, given the gravity of the crisis that Europe is facing right now.

2. Analysis

Presently there is a serious economic and financial crisis in Europe. If the Member States continue to hold on to their national currencies, without the common currency, it will be seen as a national problem and thus would be also resolved on the national level without significantly affecting the rest of the members of the union, unlike what happened in the 1980s when the economies of Spain, Italia or Great Britain responded to their domestic crisis by devaluing their currency.

Monetary integration has its deepest roots in the decision of U.S. President Richard Nixon to abandon the gold standard, which led to worldwide monetary instability (Ferguson, 2009, p. 51). European countries responded to the Breton Woods Conference with the creation of various financial mechanisms to ensure stability, especially the creation of the ECU, a basket of European currencies in which the central banks of each state were responsible for maintaining the value of their currencies within certain limits, 2.5 per cent of the mean (Figure 1).

Figure 1. Functioning system of monetary stability in the ECU



So if a currency was revalued above that limit, it was a consequence of demand of the international financial markets being higher than the supply. That is, most traders had wanted more of this currency than they could acquire. As the demand was higher than the supply, the value rose and the central bank of that state had to supply the market with more of its currency, which traded for dollars as the international currency of reference, matching supply and demand. In the case of a devaluation of currency value, it meant that the supply was greater than the demand and there was more national currency on the international market that could be absorbed. The way to stabilize the currency was to use the national central bank to buy national currency on the international market with dollars, hence equalizing the demand and the supply.

The main problem occurred when the national central bank lacked enough dollars to stabilize the value of its currency. The system functioned properly for a few years, but the 1980 financial crisis and great shifts of financial capital markets led to the extreme situation when some central banks lacked enough dollars or national currencies to stabilize their currencies, to match the supply and demand. Then it was decided to extend the limit to +/- 15 per cent fluctuation, which in reality meant the end of the system because it allowed the value of the currencies a fluctuation of 30 per cent of their value, a huge gap in terms of stability.

To avoid these fluctuations and maintain a stable financial situation, apart from other political reasons such as the predominance of the Deutsche Mark in Europe or the process of European integration, it was decided to create a single currency for the European Union—the euro.

2. 1. Positive aspects of the common currency

Decrease of costs associated with foreign currency exchange for trade. The development of the Common Market and later the Single Market in Europe meant a significant increase in intra-community trade so that a common currency meant the stabilization of trade. It reduced costs related to intra-community trade, and equaled less than 1 per cent of GDP in the EU, since all companies involved in foreign currency exchange had a substantial reduction in their business activity.

End of uncertainty. When trading between countries with different currencies and with different periods of payments and delivery, the final price may be altered depending on fluctuations of exchange rate. This creates some uncertainty and has a restrictive effect on international trade. The common currency ends the uncertainty and increases trade between the eurozone countries.

The euro's international importance. As the world's largest trading bloc, the common currency of the European Union could start competing with the U.S. dollar as international currency. This means that the central banks of many other countries will have financial reserves in euros, with consequent benefits for Europe and its economic system.

The introduction of the euro led to a decline in interest rates, which meant a period of expansion in some European economies because they had a cheaper access to loans. Nevertheless, this positive aspect is relative because some EU members already had low interest rates. It could be also included in the negative effects of the euro, as it led to an increase in debt of the weaker economies, which by now has become a worrying problem.

European identity. The introduction of the common currency has led to the strengthening of the European identity: the EU citizens being able to use their own currency in other Member States may feel the sense of belonging to a common area, to a common territory, to Europe.

The control of German economic power. The reunification of Germany created a state of panic in Europe because it involved a threat of the repeating of the German economic miracle after the Second World War in rebuilding the Communist East. It could have led to a stronger Germany than the rest of the communitarian partners and the obvious dominance of a united Germany over other European states. So the best way to prevent it was to suppress Germany's independent monetary policy, and include it in the community entity, the European Union. Owing to this, Germany lost monetary sovereignty, but shared it with the rest of its partners.

The introduction of the euro also must be understood within the prism of European integration, the long-term goal of which is the creation of the European state. One of the strongholds of a state is its monetary policy and one of its major symbols is the common currency. So from that point of view, the euro is a step closer to the final goal of integration.

2.2. Negative aspects of the common currency

The negative aspects of adopting the common currency are primarily related to loss of independence of the Member States squandering the possibility to use financial instruments independently to revive their economies in times of crisis.

Loss of the right to decide the interest rates. When a state is in a economic crisis, it can reduce the interest rates. This means that private investors have a lower return on their investments in the public sector and therefore prefer to invest in the private sector. This leads to an increase in the economic activity that eventually translates into higher inflation. But the important thing is that it will increase economic activity in a time of economic recession. On the other hand, if a state has overheating problems in its economy, it may raise the interest rates, so that investors allocate their capital to the public sector because of the highest return, which will reduce investment in the private sector and shrink the economy and, consequently, reduce the rate of inflation. Currently the interest rate depends on the European Central Bank, so the eurozone countries cannot use it to their own devices, and the European agency will only act in case of a global crisis (a European crisis affecting the majority of the common market) not in a crisis affecting only some eurozone countries. The reason is obvious—helping some states which are in need of higher economic activity would mean overheating the economy of the rest of the member countries with the negative effect of a high inflation. It means harming the healthy to treat the unhealthy.

Loss of the possibility to devaluate the currency. A state faced with a crisis situation may decide to reduce the value of its currency. As a result, the economy of this state produces cheaper goods for the international market, increasing foreign demand for the production of that state, so exports grow, the economic activity increases, and this also increases the employment rate. In turn, foreign production becomes more expensive on the domestic market. Thereby import rate falls and there is an increase in domestic demand for those products produced within the state. This increases domestic economic activity. Thus, an economy can be reactivated using this financial instrument, but its effects are limited in time and have long-term harmful consequences, since a devaluation means that the price of imports will rise. Some of these imported products, but not all, are replaced with domestic production. So prices rise as a result of more expensive imports and growth in domestic economy, causing downfall in real wages. As salaries are maintained on the pre-devaluation level and the products are more expensive, the power of employees to purchase goods is lower. This situation leads to social unrest resulting in increase in wages, which raises the cost of production. The domestic production becomes more expensive and results in the loss of the initial benefits of the devaluation. Still, it can be a useful tool to revitalize economy in a timely manner at a certain time of a crisis.

Fiscal policy. According to the Stability Pact, the countries which joined the common currency have limits to borrowing, which reduces the possibilities of increasing the deficit. In a crisis situation a country may resort to international markets to raise capital which will be later used to revive the economy, following the example of Roosevelt's New Deal in the 1929 crisis. If the state increases its public investment during a time of recession, it becomes the engine of the economy when the private sector lacks the capacity to lead the economic recovery. Obviously, during a time of economic downturn, state revenues are reduced because there is less economic activity and therefore it is less able to fundraise, so the only way is to spend more is by borrowing from foreign countries. Once revived, the economy of the state revenues increase again and use the surplus to pay the debt. This is another element that is lost on the national level, although the controls that were established have been insufficient, so that the debt crisis of the states has increased dramatically, causing huge tensions in the system and among the member countries of the monetary union. (Crafts, 2008, p. 230)

All the negative aspects of the euro are related to the loss of independence of national economies in a crisis situation, because these instruments will be under the control of the community, the European Central Bank, which is only used to benefit the entire community. So the problem lies in instances of asymmetric shocks, crises that affect only part of the community (but not the whole). The more integrated an economy is, the less likely is a crisis of this nature to happen, as a crisis that happens in one part of the common market would quickly spread to the rest of the market and the European Central Bank would act accordingly. But now the European market is not as tightly integrated, preserving certain blocks with less integration and less access to the rest of the system, leading to local crises that do not spread to the rest of the system by preventing the European Central Bank to act effectively in solving problems without harming the healthy economies. Today we have six different cases related to this issue—Greece, Ireland, Portugal, Spain, Italy and Cyprus. Slovenia probably will be the next case.

2.2.1. The case of Greece

The country has spent more than it generated, and has financed its spending by borrowing with debt. This model can only be maintained in a long term with a future increase of state revenues to meet the rising payments, basically the common obligations of Greece, and the payment of the debt and its interests. Normally it is achieved with a growth of economic activity and the subsequent increase in government revenue—in other words, the state spends today on what it will earn tomorrow. The problem is that the model cannot function during a scenario in which economic recession makes state revenues lower and the spending power is diminished. If expenditures are maintained or even increased, the state has to borrow more money, and this means more debt, increasing future costs. If the crisis persists and future revenues are not increasing, the state's ability to repay these loans will decrease, until it reaches a situation where lenders doubt the state's ability to repay its loans and fear for their investments. Under these circumstances of mistrust, international investors will not lend more money to the state which may not meet its obligations and this might lead the state to bankruptcy.

Part of the problem is that state expenditures are constant or even progressive, they are obligations of the state, unless a reform to reduce state spending is implemented. Thus, the state must reduce its spending and increase its income, which in practice means socially painful reforms, very unpopular among voters, as increasing the tax burden of citizens and economic agents, effective fighting against fraud and reducing salaries. The costs should be reduced in the less productive sectors of the system, especially those with lower influence on future economic growth, normally the public workers and public institutions. Thus, the salaries of civil servants, social spending, pensions, public enterprises, etc. would be most affected by the cost containment reforms. Revenues are increased by raising taxes, combating tax fraud and investing in economic sectors with a potential to create growth. These investments are not only monetary, but may be also legal, creating a legal framework that encourages development, which often leads to a loss of privileges obtained by different social agents. In the case of Greece there has been social and institutional fraud: the state deceived international markets by making up the accounts, showing greater economic activity than it actually had, and thus artificially increased its ability to generate revenues and meet its obligations, making the international market believe in a bigger national economic capacity. This institutionalized fraud was disclosed through Greece's economic weakness following the global crisis, after which the country had problems with paying its debts.

There was also a great fraud of social agents in tax matters. The level of tax evasion in Greece is huge compared to other community partners. Tax evasion between private fortunes and companies is common, even among the middle-class Greeks. For example, recently it was discovered that benefits were still paid to 4,000 old-age pensioners after their death (the money was pocketed by their families), and some ministers had hidden accounts in Switzerland. All these problems considerably reduce the state's tax capacity. Furthermore, the Greek public enterprises have become employment agencies for politicians and their followers, so they are not managed professionally and are economically inefficient, and their losses are substantial. In Greece there is an important social rejection to the reduction of the welfare state, pensions, salaries and other benefits, which limits the ability of Greece to reduce public spending.

Another problem in Greece is the lack of investments in productive sectors with growth potential that would help to increase economic activity. State revenues were spent on policies ineffective from the economic point of view, such as artificially high public salaries, or artificially minimum wage in the country (Tsoukalis, 2008). Thus, as the state spending has increased and revenue fallen as a result of the economic crisis, Greece still cannot meet their payments and responsibilities. Because a member of the common currency cannot devaluate its currency, Greece cannot lower the interest rate and simply increase its deficit against the provisions of the Stability Pact. By the time the markets decided not to trust Greece's ability to repay loans, funding became more expensive while the collapse of Greece's economy is coming closer. The result is a bailout led by the strongest economies in the EU, as well as some international financial institutions such as the International Monetary Fund, and the loss of independence of the Greek government by having to comply with the requirements of the rescue plan reforms to reduce costs and increase the revenue. Even the public debt was reduced by half, since Greece cannot repay the other half unless it gets another loan from the IMF and the other members of the eurozone.

The problem is very basic—Greece cannot keep its high standard of living under the current circumstances because it does not generate enough money to pay for it. The country was paying its social system with borrowed money and now cannot repay it. Greece has the option of reforming the economy, cut the expenditures, decrease the incomes of the Greek citizens and lose the financial wealth of its citizens or leaving the euro by re-adopting and devaluing the drachma, not paying its debt with international investors, and thus isolating itself from the international world. Both options seem difficult to accept and will have catastrophic consequences for Greece, its European partners and the holders of Greece's public debt. The Greek government has been playing with their European partners because of the potential consequences to the euro should the country leave the common currency because it could be seen as the first country forced to abandon it, creating a crisis that could lead to similar situations in other Member States of the eurozone, such as Ireland, Portugal, Spain, Belgium or Italy, in order to get more money from Europe. At the same time the Greek government did not reform its economy because of the social rejection, so it still depends on external money to keep the country running. Unless the Greek government starts a serious reform program cutting expenditures and increasing incomes, the international aid will stop and the country will be bankrupt. The situation in Greece has been fundamental to understand the crisis in Cyprus. The behavior of the population towards the state in terms of taxes is similar, with a high level of tax evasion and corruption. And the exposition of the main banks of Cyprus to the public debt of Greece and the reduction of the payments agreed by Greece with the support of the European Union has meant big losses for the banks of Cyprus, increasing their vulnerability and exposition to the current crisis.

2.2.2. The case eland

In Ireland the level of fraud is not as high as in Greece, so the situation is radically different. Ireland's economic system was based mainly on tax breaks for big corporations who came to Ireland, where they could pay less taxes and in turn had access to the entire European common market. These world-class companies, such as Microsoft, settled on Irish soil with only one goal—to work in the European common market within a low-tax location.

The second factor in Ireland's economy was the construction sector and real estate, which was the main driver of Ireland's economy in the years before the global crisis. With the fall of this economic sector there was a great reduction of state revenues. In turn, Ireland did not raise taxes in order to keep the international companies on Irish soil. The government did not generate much revenue, and even increased its expenses because the Irish financial sector was in deep trouble for the debts owed to property developers. The situation was critical, close to insolvency. Ireland decided to save its banking system by supporting the main banks with state monetary muscle, but as huge amounts of money were spent to save the banks, while the state revenues decreased due to lower economic activity, the country was unable to meet its obligations and a bailout was needed from its community partners. It meant a loss of independence for Ireland by having to accept the reform plan developed by participants in the bailout. In the course of the reforms higher taxes were imposed on large corporations upon the decision of Germany who saw it as an unfair competition.

The case of Ireland is also special because of its strong links with the United Kingdom. The British do not have the common currency, and therefore have remain independent in their financial decisions, but they were involved in the crisis of the euro because of implications in Ireland's economy, which are strongly integrated in the British economy. So, the bankruptcy of Ireland's economy would have strongly affected UK's economy and financial situation. This is why the British government participated actively in the bailout developed by the eurozone countries for Ireland. Right now, the government of the UK does not want to get involved in the euro crisis, which could have important consequences for Ireland.

2.2.3. The case of Portugal

In Portugal, the situation is not very complicated because the problems are generated by a poorly productive economy which has been financed through borrowing. Revenue did not evolve analogously to expenses and this has led to a situation in which state has been unable to meet its obligations. The need to reform Portugal's economic system therefore became unavoidable, but such reforms were not carried out because of elections. Nobody wanted to assume the political cost of the reform or face the rejection that arose among the important social actors in the country, such as trade unions. This clearly points out the difference between politicians who rely more on short-term thinking and statesmen who are concerned about the situation in the long term. The lack of agreement among Portugal's ruling classes has led to the need to request a bailout from its EU partners and the implementation of reforms from the outside with subsequent loss of independence. Portugal is currently cutting expenditures and raising taxes to balance the national accounting, and these actions are presented as a European requirement to reduce the electoral cost of these measures and give them more respectability while avoiding the loss of credibility of national politicians among the Portuguese.

2.2.4. The case of Spain

Spain is a complicated case because of the size of its economy and its possible knock-on effect to the whole Community as a country too big to fall. Spain had a period of unparalleled economic boom owing to the real estate sector. During certain periods of time the country built more houses than Germany and France combined, although the Spanish population is 46 million and Germany and France have more than 140 million people. The crisis in this sector represented a sharp drop in income for the state. For example, the sale of flats in the first quarter of 2011 was 11,000 million euros, while during the same period four years ago it was 38,900 million euros. Despite lower incomes, Spain increased its public expenditures in order to activate its economy. This action was financed by international loans through public debt. The money was fictitiously invested in maintaining the welfare state without investing in more productive wealth-generating sectors, such as administrative expenses of the state that are duplicated as a result of regional autonomy status, or social benefits, pensions and public unemployment payments. Other problems in Spanish economy are corruption, crisis in the public banking sector and its privatization, lack of innovation and foreign presence of Spanish companies, and high unemployment rate. The bank system is still in trouble because of its exposure to real estate. As many real estate developers could not pay their loans, the banks seized their properties and included them in their balances with the economic value of the times of economic expansion. This means that their value is not real, but should the banks reduce real estate prices in order to get rid of their holdings, their losses would be substantial. Spanish government has decided to support it in order to avoid the collapse of the banking sector as a minor harm. The current number of new buildings in Spain is around 700,000, plus the second-hand houses on the market. It will take many years with current prices for the real estate market to absorb this stock without any new building activity. But during 2011 more than 250,000 houses have been built in Spain increasing the problems of stock but avoiding the collapse of the real estate sector which currently employs more than a million workers. On the other hand, the incomes of the Spanish citizens have been reduced by government cutbacks, which is the effect of the crisis and the reduction of bank loans for real estate purchases, making the problems in the real estate market more imminent.

Spain's another main problem is high unemployment rate, involving 4,998,225 people. It means a huge reduction in state revenues from the taxes of people who used to be employed and now are not, plus an important increase in state expenditures via social policies such as unemployment payments and other economic and social aid for those without work, and finally the impossibility of reforming the real estate sector reducing the current rate of construction because it would result in even higher unemployment rate.

Thus the hope of Spain is to reduce expenses and increase revenues. Some reforms have been carried out, such as reducing the salaries of public employees and subsidies, in addition to cutting back other unnecessary expenses. But the reforms have been insufficient and will need to be deeper in order to escape the ghost of the bailout that could have tremendous consequences in the whole European Union. Discussions are ongoing about the need for a more flexible labor market, reducing the regional institutions expenditure—totaling more than central government spending—and investments in productive sectors with potential capacity to generate wealth. In turn, Spain has increased its revenue capacity by increasing taxes and combating tax fraud. Also, the state revenues have been increased by the activity in the current motor of Spain's economy—tourism. This, however, is a temporary solution that must be managed cautiously because the growth in tourism is a consequence of the crisis in Arab countries. Tourists looking for beach and sunshine come mainly from Northern Europe. Although Spain is comparatively more expensive than countries like Tunisia or Egypt, recent changes in the countries' governments and the resulting political instability has made European tourists prefer Spain who offers safer holidays, despite its being more expensive. Agriculture, the other important sector, has not been affected by the crisis, as it is one of the few sectors of Spain's economy oriented to the external market (Ramiro Troitiño, 2013, p. 302).

Still, more serious reforms are needed to solve the problem in the medium and long term, a process that the current government is undertaking along with an important program of expenditure cuts provoking a reduction in the living standards of Spanish citizens and with a negative impact on economic growth.

2.2.5. The case of Italy

Italy is one of the biggest economies in the European Union and the seventh largest economy in the world. The situation of Italy is in many cases similar to that of Spain, but it is more serious because of its larger scope. Corruption is more widespread than in the other European countries, the subsidies are numerous but ineffective from an economical point of view, the unemployment rate is high. Then again, the tourism industry is also big in Italy and has benefitted from the recent disturbances in the Arab countries, increasing the country's revenues and being beneficial to its economy. Also Italy has a problem with regional governments and the overdeveloped national, regional and local institutions. These institutions function to support politicians rather than as effective or needed public institutions. Italy's agriculture has been also less affected than other economic sectors because of its orientation to the European market.

But there are also differences. First, the real estate, which is less developed in Italy than in Spain, and, second, the historical division of Italy into north and south. The northern part of Italy, which is more industrialized and strongly linked with the European markets, is in a better position to overcome the crisis, but the southern part, which continues to be heavily subsided by the state needs to change its path of growth and public expenditure.

Italy's political situation is also different. The previous government opted to avoid the crisis by concealing it with some dramatic reforms that seemed to be effective on paper but had small implications to the real problems in Italian economy. Anyway, the changes in the Italian government and the strict program of reforms by the technocrat Monti might succeed in reversing the situation. Italy cannot afford to finance its expenditures with public debt anymore because it is already huge, much bigger than in the other cases described here, so it has two possible alternatives to reform the economy: expending more in order to increase the economic activity and its revenues in the future or reducing its expenditures in these cases in which the economic benefits for the whole country are small or non-existent. But as Italian politicians continue to have confidence in the size of the country's economy to avoid a bailout, they are thus trying to win time to turn back the economic growth in the near future without carrying out any important reforms; their support to their new technocratic government could be able to steer the country off the path of ruin (Costa-Font, 2012, p. 65). This strategy could be effective because should Italy go bankrupt, the European Union will obviously collapse because it would not have the financial muscle to help such a big economy and this could mean the end of the eurozone as we know it today and eliminate the future possibilities of the area. But it also depends on how fast the world will recover from the crisis, and if it does not happen soon enough, Italy will not be able to last without important and real reforms.

2.2.6. The case of Cyprus

Cyprus was the last member of the eurozone to be affected by the crisis. The small Mediterranean country was accepted as a member of the EU despite its geographical location and because of its Greek roots. Many internal problems prior to the accession were obviated in an irresponsible behavior from the part of the European Union. The optimism at the time of the enlargement supposed that once the country is a member of the EU, it will reform itself and fix its major problems. Nevertheless it seems possible that the enlargement was carried out in order to keep the Turkish accession on standby because of the confrontation between Turkey and Cyprus. The current conflict could become more serious because of the gas reserves found in the national waters of the island and the fight over its sovereignty between Turkey and Cyprus. Unless the conflict is solved, Turkey will not join the EU because unanimity between the Member States is required for any new membership, and Cyprus is unlikely to accept it if the relations with Turkey are not improved.

Nevertheless, the economic system of Cyprus is basically based on foreign investments linked with tourism and real estate, and the banking system. The British presence on the island is very important, with permanent military bases located in Cyprus and an important influx of tourists. Cyprus' other important international partners are obviously Greece and Russia. For years after the enlargement there was an important economic growth on the island, with growing numbers in tourism and the construction sector. The prices of real estate grew drastically within a few years increasing the incomes of the state, which is in a similar position than Spain. The current crisis has meant a decrease in real estate activity as a consequence of restricted access to finances. As the demand depended mainly on the European Union's citizens, the crisis in the UK and other EU Member States had a big influence on the island's construction sector, resulting in a significant decrease in the incomes of the state. The Russian demand of real estate has grown in the last years, but has not been enough to substitute the European demand.

The third main sector in the economy is banking, with an over-dimensioned sector representing the most important part of the economic activity of the island. Nevertheless there are other countries in the European Union—such as Malta or Luxembourg—with higher influence of their banking sector on their economies. The weak legislation of Cyprus has meant an influx of capitals from dark or dubious sources, becoming a fiscal paradise for money-laundering. Also the exposition of the banking sector to Russian investors is very important, amounting to around one third of the deposits coming from Russia, the legal origin of which is at best doubtful. The exposition of the banking sector in Cyprus to the public debt of Greece and to the real estate sector has been a decisive factor in its collapse. Also, its excessive size has led to the incapability of Cyprus to solve the problem alone and clearly shows the country's dependency on its European partners. The European Union has given an important loan to Cyprus under strict conditions, including the requirement of keeping a share of deposits higher than 100,000 euros to pay for the financial recovery, plus important measures to reduce the importance of the financial sector in Cyprus.

Obviously it is difficult for Cyprus to accept the EU's plan but the country has no real alternative if it wishes to avoid a full economic collapse. The country's economic model will change and its role as a tax heaven will diminish in the future.

This has created an important precedent for further actions of the European Union, with the involvement of the financial sector and the savers, local and international, in the bailout process.

3. Solutions

As these six countries are eurozone members, their problems have become Europe's problems because a country's bankruptcy would result in tensions that could lead to the end of the common currency and a major crisis in Europe. But the crisis in the economies of these four countries has not spread to the rest of the Community, where the core economies, France and Germany, are growing and overcoming the crisis. It makes impossible for the European Central Bank to use any financial instruments available to help the countries in crisis without harming healthy economies in Europe. The solution to current problems on the Community level depends largely on the following factors:

The historical evolution of the construction process in Europe teaches us that the EU will never return policies to the Member States, because it will always add and never subtract. As the dissolution of the common currency, or abandonment of the group of countries with problems, is not feasible within the historical development of the EU, this option could be used only in the case of Greece, who is a minor partner of the EU. Be that as it may, it is not likely to happen as Europe is in a process which dates back to the 1950s and is still developing; and the Member States will try any means to avoid this solution.

Germany is the largest economic power in Europe and its economy is based on export, so an important part of the debt owed by the countries in crisis has been devoted to buying German products. The destination of two-thirds of the exports of German companies are the other EU countries, so the "Teutons" have enjoyed big economic growth and higher tax revenues from the economic activity of German companies. It makes no sense that Germany should refuse to help these countries against its own economic interests. Here the problem is the management of the benefits generated by German companies because of their exports to the rest of Europe, which are under the control of the German state and the European Union. Therefore, it is radically wrong for Germans to use their own money to save the struggling economies of the eurozone. Germany is the main beneficiary of a common policy, internal market, but there is no a common policy in the European Union to manage in periods of crisis such as the current one. Germany benefits from the European Union, but its contribution to help the countries with problems is regarded as a national generosity.

The current bailout is temporary and unstable, depending on the willingness of the richest states, that is Germany and France, although France is showing itself as much more flexible. The rules of the rescue are not decided within the EU but by the strongest states, which is a breach of the principle of Communitarian solidarity and the spirit of coexistence and common management. On the other hand it also lacks efficient tools to introduce reforms in the countries receiving financial aid, because it is based primarily on good faith without coercive legislation. It leads us to a situation of dictatorship of the rich countries to unilaterally determine the conditions of redemption, and to fraud in the weak countries that do not meet their commitments. The prevalent opinion in these countries is that Germany is ruling the EU alone and establishes conditions for their economies. It is clearly against the spirit of the European Union which predetermines that the community of Member States should decide together for the benefit of the whole. Germany is currently more powerful in the EU's institutional framework and dominates the plans of the union to rescue the weaker economies. Germany is always going to be more powerful than other states because of its size, population and economic power, but with deeper integration its power could be controlled by the majority of the Member States, who would force Germans to be more open to a consensus.

4. Cutting public expenditure would not end the crisis

The main problem of the economies in recession is finding investments to push the economic activity higher. Keynes, whose ideas are still topical today, even when the main economies of Europe are preaching state prudence, already spoke about fiscal austerity during the periods of expansion in the economy but during recessions a cut in public expenditure would lead to a deeper depression of the economy. European leaders reacted to the crisis by focusing on public debt instead of employment (Krugman, 2009, p. 170), which has been a great mistake. In their reaction to the crisis, the Europeans relied on the trust of economic agents on the general accounts of national governments as the best way to increase consumption in an environment of global recession and activate the country's economy. The so-called expansionary austerity is not working, as the crisis is deepening in economically weaker European states. The case of Ireland has been used as an example—while in 2010 it seemed that the economy of the Irish tiger would recover due to the austerity measures, the national accounts later in the year showed that it was just a mirage (Ferguson & Niall, 2009, p. 46).

As the eurozone members do not have the alternative to devalue their currency, or use the interest rate or increase public debt in a short period of time without paying outstanding interests, they obviously cannot come up with the money to shake and jumpstart their economies in order to overcome the crisis. Austerity measures are needed in order to avoid national bankruptcy, but it should be focused on nonproductive sectors, eliminating all superfluous expenditures (Krugman, 2011, p. 63). The austerity measures could depress the economy even more, as the unemployment rate will grow, while state revenues continue to decrease and expenditures to grow. Hence, the main problems are where to find financial resources to activate the economy via public expenditure and how to design and apply credible economic plans in countries that have already displayed an obvious incapability to fulfill this task.

In addition, the effects of the financial and economic crisis have varied significantly. The Baltic economies and Greece were the most severely affected with a loss of actual individual consumption (in terms of volume) of 12 to 15 per cent between 2008 and 2011. While actual individual consumption started to recover in the Baltic countries in 2011, the contraction accentuated in Greece, in connection with the deepening recession and debt crisis, so that the losses between 2008 and 2011 increased to nearly 15 per cent. In Romania, Hungary, Bulgaria, Ireland and Poland actual individual consumption also fell by 5 to 9 per cent from 2008 to 2011, while it expanded by 5 to 8 per cent in Luxembourg, Sweden and Poland. However, in 2011, the situation improved in most Member States, with Ireland, Portugal and Greece being the main exceptions (Gerstberger & Yaneva, 2013, p. 3).

5. Conclusion

The only acceptable solution to the current economic problem is to further EU integration, the common management of the problem through the creation of a European Economic Government to manage the costs and revenues on a common ground based on communitarian legislation and new communitarian institutions. This does not mean the end of the regional economic management of the states, which would continue to manage the countries' respective budgets, albeit reduced, to develop national policies and influence the European Economic government via the European Council. It will be the creation of a European entity, funded with European taxes paid by European citizens and companies operating within the common market. The European taxes will provide the European Economic Government with enough financial muscle to address the economic problems of the European states, alleviating the effects of asymmetric shocks in the European Union with a common management of expenses and incomes.

The idea is feasible and could work as in the case of the federal government of the United States which faced the crisis in California in the 1980s. The crisis was a consequence of the U.S. federal government cuts in defense spending after the Cold War, with the resulting crisis in the mostly California-based weapons industry. A crisis struck this state but it did not spread to the rest of the country. Thus, the Federal Reserve of the United States could not use financial instruments such as interest rate or devaluation of the dollar to solve the problem in California because it would have hurt the economies of other U.S. areas whose economic performance was good. The revenues of the state of California declined, and reduced its transfers to the federal state of the country, but at the same time, the federal state, despite receiving less money from California, increased funding to the state to alleviate the crisis. It helped to increase California's economic activity and solved the crisis. In other words, there was a huge transfer of money to California from the other economic areas of the United States via the federal government to solve the economic crisis affecting just one part of the common market.

The members of the eurozone have lost their monetary independence, and are currently in a big need of funds to activate their economies. As today the European Union holds monetary power via the European Central Bank, it is logical that the EU will also provide the needed funds to the specific Member States. On the other hand, these countries have shown a lack of credible economic governance, and the European Economic Government could also solve this situation, being the institution in charge of developing credible plans and overseeing their right implementation. The member countries should adopt the communitarian rules in their national systems. There will be resistance to the inclusion of a new tax in Europe, but first of all it should replace the existing taxes in order to avoid a tax increase with negative effects on the economy. The tax should be paid according to the economic activity, and the areas with more economic activity, who thus benefit more from the European common market, will contribute to keeping this market in particular, and Europe in general. It could also help with the problem of corruption and mismanagement in these countries, adopting a European model which would be able to enforce the legality in these states.

Finally, a European Economic Government would avoid the current situation of the strongest economies dominating over the weakest. The rules of financial help given to countries such as Greece, Ireland or Portugal are decided by the main donors, mainly by Germany. In a common Economic Government decisions would be made by all its members according to a system of qualified majority in which countries with stronger economy would have more votes and this would avoid any single state vetoing any decision. It will create a more democratic and equal system where all the members share the benefits and losses of the European integration. A strong Germany is not even good for the Germans themselves, because its government would almost always act according to its national interests, because it is chosen by the German people. It could lead to the end of the EU and thus the end of the Common Market with huge negative consequences for the export-based German economy.

This current crisis can only be understood in the context of the European integration process, as one stage in the path of changes, and its most likely effect will be the deepening of the integration. Currently some steps have been made in the right direction, but they are very moderate, only temporal solutions for a long-term problem that could be implemented again and again until a final solution is reached. Any measure to fight the crisis without the needed integration in the form of a European Economic Government would be just a temporary patch to solve a critical point and would prove ineffective in the long term.

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